No. 3612

IN THE

United States

Circuit Court of Appeals

For the Ninth Circuit

H. C. ANDERSON, *Appellant*

vs.

O. H. AVEY and PAYETTE VALLEY LAND AND ORCHARD COMPANY Ltd., a corporation, *Appellees.*

Reply Brief of Appellant

Upon Appeal from the District Court of the United States, District of Idaho, Southern Division

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STATEMENT

Pursuant to the permission granted by the Court at the oral argument of the cause this reply brief is filed by the appellant, having for its purpose rebutting briefly the answering argument of appellee O. H. Avey and answering that portion of appellee's brief which raised questions other than those considered by the appellant in his brief. Appellant will, therefore in this brief consider the points made by appellee in practically the same order in which they appear in his brief, and as they were considered somewhat by appellant's counsel on oral argument.

ARGUMENT

Appellee has directed some attention to mathematical computation through which he claims it is apparent that a portion at least of appellant's stock is of the issues complained of in the bill, but fails to call attention to the possible cancellation of certain of the shares of stock or that appellant may be an innocent transferee of shares and the holder of a portion of the shares to which no question is directed. It is of course clear that if appellee claims that appellant took with knowledge of the situation or consented or acquiesced therein he should plead such matters as a defense since they are not properly cognizable on this appeal, which concerns the construction of the bill only. Certainly there is no presumption that appellant is not an innocent holder of the stock, but rather, under the Idaho decisions, the presumption is that he is an innocent holder thereof and the burden is upon appellee to plead and prove otherwise.

> "Possessors of certificates of stock are prima facie presumed to be bona fide holders and it is incumbent upon appellant to allege that respondent was not a holder in good faith without notice of the fraud charged."
>
> Feehan vs. Kendrick, 32 Idaho 220; 179 Pac. 507.

So, too, on oral argument, appellee's counsel contended that the case of Wall vs. Basin Mining Company, Ltd., 16 Idaho 313, 101 Pacific 733 (erron-

eously cited on page 19 of Appellant's brief as reported in 17 Idaho 317, 100 Pacific 753), and the case of Feehan vs. Kendrick, supra, contained the expressions of the Supreme Court of Idaho upon the construction of the principal section of the Idaho Compiled Statutes in question here, namely: Section 4728, but a cursory examination of these cases will indicate that the first of them merely passes upon the power of a corporation to assess (using the term "assess" in its strict sense) shares of stock concededly fully paid and not the power of a corporation to issue stock as fully paid when not in fact so paid or the liability of the stockholders who had not paid par value to the corporation itself for the balance; and that the second case was a creditors' suit involving principally the applicability of a particular section of the statute of limitations of the State of Idaho. Certainly it does not pass upon the fourth paragraph of Section 4728. (See Appellant's brief page 12.)

Turning now to the principal contentions of appellee, we first notice the contention that no question can be raised as to the exchange of property for stock because, it is claimed, the Board of Directors placed a valuation upon this property equal to the par value of the stock and their finding of value is conclusive under Section 4752, Subdivision 9, quoted in appellee's brief, pages 14-15.

The contention fails to consider or analyze the allegations of the bill which does not at any place allege a valuation on the part of the Board of Direc-

tors. It is merely alleged, in effect, that the stock was issued without crediting the true value upon it. That is to say, in violation of the fourth paragraph of Section 4728 and the by-laws of the company, the stock was credited as fully paid when in fact nothing was received except worthless options in the one case, and in the other case only $25.00 in cash, when the par value was $100.00. This crediting of the stock as fully paid when in fact nothing, or but $25.00, was received is in itself a sufficient allegation of fraud within the meaning of the statute relied upon by the appellees.

> "Gross or intentional over-valuation is in itself proof of fraud."
>
> Clinton Mining & Mineral Co. vs. Jamison, 256 Fed. 577-580 and cases cited.
>
> 14 C. J. section 1489, page 963; Section 648, pages 459-460.

The result would be that the Directors and Avey, having full knowledge of the law and the lack of value of the property taken, must be deemed to have agreed that the full amount credited should be paid, particularly since the Idaho statute makes no formal requirement for subscription,

> Fletcher Cyclopedia of Corporations, pages 1189-1192,

and of course the payment of $25.00 per share was not sufficient to constitute a payment in full, no matter what the Board of Directors might attempt to find as to such payment or its value.

However, it is clear that any valuation of property taken which the Board of Directors might make within the terms of the statute making its finding conclusive, must have equaled the full par value of the stock exchanged in view of the requirement of paragraph 4 of section 4728 (see Appellant's Brief, p. 12), that only the amount actually received may be credited upon the stock; it follows that as here the stock was credited as fully paid, then the Board must have valued the property at par of the stock exchanged—$70,000.00—to make its valuation conclusive, but this is not even appellees' contention, as clearly appears from his answer (which was inserted in the record for such aider as might be in it) wherein it is alleged (Record, page 18) that the stock issued was not of the value of $70,000.00 and had no actual or market value whatever and that (Record, page 23) "none of said capital stock of said corporation has ever at any time been worth its par value nor more than the sum of $25.00 per share, nor has it ever at any time had a market value"; hence immediately after the transfer of the property the stock was not worth over $25.00 per share and consequently the property itself could not have been worth over 25 per cent of the par value of the stock for which it was exchanged. The appellant directly alleges that the property was without any value at all, as the directors knew, and this, as has hereinbefore been said, was a sufficient allegation of fraud under the statute relied upon by the appellees.

Such a credit amounted to an attempt to give special terms which were void in themselves and left the subscription a clear unconditional one for the full amount of the par value of the stock.

> "A corporation clearly has no power to agree with subscribers upon special terms which are in violation of express charter, statutory or constitutional provisions. If it does so the special terms as a general rule are void, not only as against subsequent creditors but also as against the corporation itself and they cannot be set up either to defeat an action upon the subscription or as a foundation of an action against the corporation. This principle has frequently been applied to special agreements by which subscriptions are to be paid in part only * * * where the * * * general statutory * * * provisions require payment in full. * * *.
>
> "A corporation has no authority to accept subscriptions upon special terms when the terms are such as to constitute a fraud upon the other subscribers. In such a case, however, the subscription is not void. The fraudulent and unauthorized stipulations are void and the subscriber is liable upon his subscription as if no such stipulation had been inserted. It has been held, therefore, in many cases that any secret agreement between a subscriber for stock in a corporation and the corporation or its agent or promoters by which he is allowed to subscribe upon different terms than other subscribers,

since it is a fraud upon the latter, and any secret agreement by which he is to be released in whole or in part from liability upon his subscription, since it is a fraud both upon other subscribers and persons who afterwards become creditors of the corporation, is void and the subscription may be enforced by the corporation * * * as if no such agreement had been made.

"The reason for the rule insofar as it relates to the other subscribers is that each of the subscribers in making his subscription 'may be supposed to be influenced by that of others and every subscription to be based upon the ground that the others are what upon their face they purport to be'.

"To hold that the invalid special terms make the entire contract void would be t ogive full effect to the fraud and thus release the subscriber and throw upon the other subscribers that part of the common burden which he held out to them he had assumed, while by holding that the secret agreement alone is void the contemplated fraud is defeated and justice is done to the other subscribers and no wrong is done to the parties to the contract of which either has reason to complain."

Fletcher Cyclopedia of Corporations, Vol. 2, pages 1315 to 1316, 1324 to 1329.

So at page 17 of Appellee's brief it is said:

> "It is possible that under the allegations of the bill Appellee would be liable to creditors."

and this, of course, could only be true in case there remained some part of the par value unpaid. No part of the par value would remain unpaid if the Directors had made a proper valuation and the statement of Appellee in his brief above quoted is significant in that it clearly indicates Appellee does not contend that the Board of Directors valued the property taken at the par value of the stock.

No attempt will herein be made to distinguish the several citations made by Appellee in his brief, but it is confidently asserted that such citations are distinguishable from the case under consideration upon one or more of the following consideration: First, that no statute existed in the state wherein the decision was rendered similar to the fourth paragraph of Section 4728 or to Section 4715 (set out at pages 10-12, Appellant's brief); second, that the stockholders with full knowledge acquiesced in the transaction; third, that the vendors and directors making the valuation or special agreement were different persons, so that the directors acted uninfluenced by personal interest; or, fourth, that the valuation was made in absolute good faith, fairly and clearly without any fraud or fraudulent intent.

NECESSITY FOR CALL AND JOINDER OF SIMILARLY SITUATED STOCKHOLDERS

Appellee in his brief attempts to make a point of the fact that the Board of Directors of this corpora-

tion made no call upon the stockholders for the amount unpaid upon the par value of stock issued to them and that all stockholders who are similarly situated have not been made defendants in this action. It would be a strange doctrine that would permit the Appellee to object that no call had been made when he and others in his situation are in sole control of the corporation as majority stockholders and directors, and, as is alleged in the bill, have not only refused to make a call, but have attempted, and will attempt, to assess the appellant. It is not surprising, therefore, that on oral argument no mention was made of this point by counsel for appellee. It does not appear from the pleadings that collection is to be enforced only against appellee and in any event there is no requirement that all stockholders be joined in an action to collect unpaid subscriptions, the liability for which is several. Nor is there any showing that other similar suits are not pending against other stockholders in like situation. It does appear that the object of collection of the amount due is to pay debts and carry on the business of the corporation and in such a case each stockholder is individually and severally liable for the amount unpaid by him.

A subscriber's liability is a debt to the corporation which it may collect "and the amunt unpaid may be recovered by the corporation even though there are no corporate creditors." Where a corporation is adjudged insolvent and has ceased to be a going concern there can be collected only their pro rata share of

the amount necessary to pay creditors and wind up its affairs.

> "But this rule has no application when a corporation is a going concern and it is sought to collect the unpaid subscriptions for the purpose of continuing it as such and to further its business and purposes.
>
> "The liability of the subscribers is several and not joint."
>
> Fletcher Cyclopedia of Corporations, Vol 2, page 1259.
>
> Bergman vs. Evans, 158 Pac. 961 (Wash.).

The refusal to make a call is specifically alleged and under such circumstances no call is necessary.

> Fletcher Cyclopedia of Corporations, Vol 2, pages 1514, 1528.

And the specific point was raised in the case of Bergman vs. Evans, *supra*, under almost identical pleadings, and it was there held "that the suit in itself is equivalent to a notice of call and a Court of Equity has the power to make the call upon a proper showing such as we think has been made in this case."

ESTOPPEL AND LACHES

It is not surprising that counsel for Appellee made no mention upon oral argument of estoppel and laches. The matter of estoppel is based upon the claimed knowledge of the Appellant as a stockholder, but there is nothing in the bill which indicates such

knowledge. On the contrary, it is affirmatively alleged that appellant was ignorant of the transactions and that they were without his consent. He is presumed to be an innocent and *bona fide* holder of the stock, as has hereinbefore been set out. Feehan vs. Kendrick, *supra*. And if Appellee claims an estoppel by reason of knowledge he should plead it as a defense and show that he has been prejudiced by the non-action of the appellant.

> "The appellants also contend that respondent is estopped by his laches and conduct from urging this action. In support of this they maintain that with knowledge that the subscriptions had not been paid in, he participated with the other directors in borrowing money for the corporation and waited seven years before complaining that their failure to pay up was an injury to the company, but there is no showing that appellants have been in anywise prejudiced by the action of respondent or that a change of conditions has taken place during the period of delay. * * * Laches is not a bar to a stockholders' action, if neither the defendants nor others have been thereby induced to act upon the matters complained of. * * * Nor is it a bar where the illegal acts continue to the date of the suit."
>
> Bergman v. Evans. supra.

Nor can it be contended that either the statute of limitations or a period analagous to it which might be designated a period of laches has run or com-

menced to run until the occasion for its enforcement has arisen. If the action be held to be founded upon the fraudulent act of the directors and stockholders (who were the same persons), then the statute of limitations would not begin to run until the fraud had been discovered. Under Section 6611, Idaho Compiled Statutes, "the cause of action in such case is not to be deemed to have accrued until the discovery by the aggrieved party of the fact constituting the fraud or mistake" and as the date of the discovery does not appear in the bill, it is a matter purely of defense on the part of the appellee and to be set forth specifically in his answer; but in any event, an action upon a subscription for the unpaid par value does not accrue until a call has been made for the unpaid par value or until the occasion having arisen for the necessity of the call a reasonable time has elapsed without the making of the call by the Board of Directors. It is contemplated by the Idaho Statutes, Section 4733, which is set out in full at page 13, Appellant's brief, that the call need not be made at any specific time but may be made whenever the occasion or necessity arises.

It is said in Fletcher's Cyclopedia of Corporations, Vol. 2, pages 1465-1469, that when a subscription is payable on call, then:

> "the statute of limitations does not commence to run until a valid call or assessment is made and then runs against that call or assessment only.
>
> "Until such call there is no obligation of the

stockholder to pay. It may never be made." Until necessity arises "the duty of payment is only a reserve duty for possible contingencies and until they happen, either by calls by the corporation on the subscription or by the rights of creditors, there is no duty of the subscriber to pay, no right of action against him for non-payment, and no starting point for the statute of limitations. * * *"

"According to the better opinion it is not necessary that calls be made within the period fixed by the statute for commencing actions on subscriptions."

CONCLUSION

Appellant confidently asserts that the bill states a cause of action against the Appellees, under the allegations of which he is entitled to recover on behalf of the corporation the amount unpaid upon the par value of the stock of Appellee. So far as appears from the record, it cannot be successfully contended that the par value has been paid or that the statutes of Idaho and by-laws of the company did not require the full payment of the stock. That being the situation and under the peculiar equitable features of this case—the double dealing of Appellee as an individual seeking a profit and gain for himself with the corporation of which he was the executive head and one of the principal stockholders and a director—the Appellee must be held to a liability to the corporation as upon a subscription to pay the full par value

with a credit only for that which he has actually paid and the decision of the lower Court should be reversed so that the case may be presented upon its merits.

Respectfully submitted,

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